DOW THEORY LETTERS INC.

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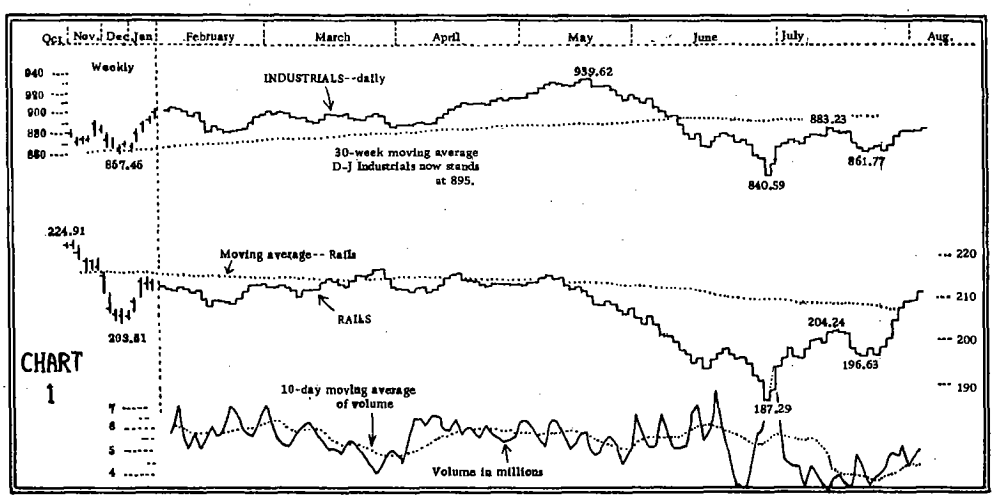
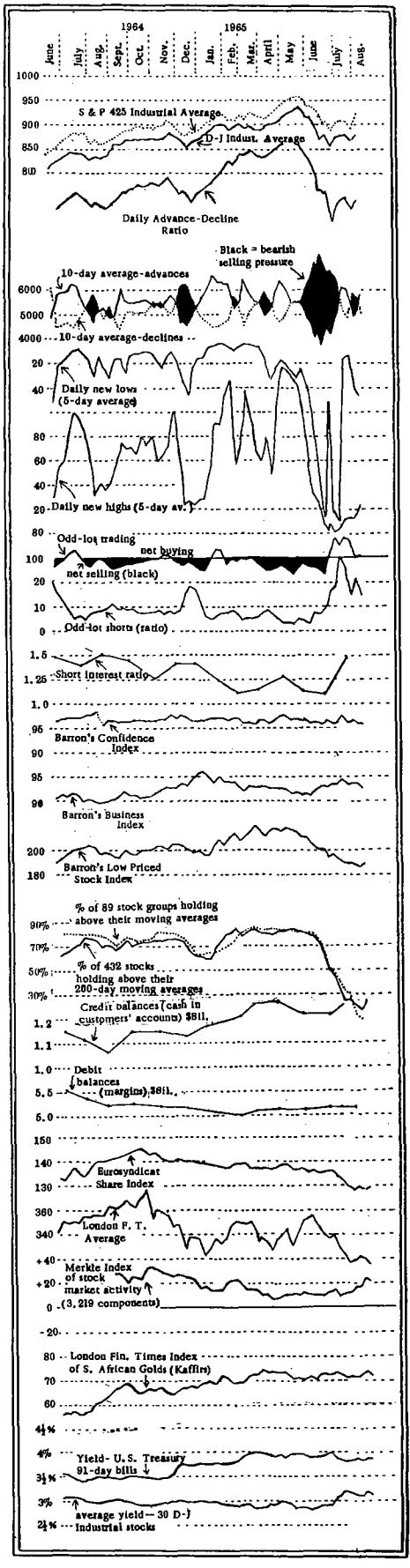
THE MARKET: On June 25 a Dow Theory bear signal was registered. The market continued to drop thereafter, recording its lows three days later on June 28. Following the violent May-June decline, the market reversed direction, and an advance carried through July and into August. The rallying action was not unexpected, and a few of the upside possibilities were outlined in the last Letter. It is worth repeating, however, that this type of rally (coming, as it has, within the broader framework of a bear market) is the most dangerous possible kind of rally to enter. Therefore, I have suggested that my subscribers try to hold any potential "get rich quick" instincts in abeyance during this rally and "watch the game" rather than attempt to play it.

Every advance (whether in a bull or a bear market) requires a rationale to satisfy the newspapers and the public. But it should be remembered that the best advances frequently provide the least obvious fundamentals (the "good news" usually hits the newspapers after the rally is over). Not so with the current rise, which is widely heralded as discounting an expansion in business predicated on an expansion of the war in Vietnam. A few analysts have made so bold as to question this thesis, however. For instance Anthony Gaubis writes in his latest report that "Incoming orders are following relatively stable even if mixed trends, and it does not appear likely that increased military spending for the war in Vietnam will amount to the equivalent of even 1% of our Gross National Product." Hamilton Bolton notes in his new August report that two other periods of less than world war proportions might be compared with the present. During the 1939-41 period (before the U. S. entered World War II) with the U. S. banking system far less loaned up than now, "business expanded but stock prices declined." During the Korean War with a condition of excess liquidity in the banking system, "business expanded rapidly, commodity prices rose sharply but stock prices topped out in 1951 for a good two-year consolidation." So the current Vietnam war is no guarantee of a new bull market (and it should be remembered that the banking system is now far less advantageously situated than it was in either 1939 or 1950).

From the standpoint of the Averages, the most impressive part of the rally so far has been the upward surge of the Rails. Letter 295 stated: "Consider the secondary trend bearish unless the July highs of 883.23 (Industrials) and 202.24 (Rails) are jointly bettered. If the July peaks are hurdled, we could get an important extension of the secondary upward correction." On July 29 Rails spurted above their preceding high of 202.24. By August 2, with Rails still climbing, Industrials closed within 1.38 points of their July (883.23) peak. August 3 saw a mild decline while August 4 witnessed a market which was again pushing towards the July highs (see end of this Letter for late comments).




1964
1965
June July Aug. Sept. Oct. Nov. Dec. Jan. Feb. Mar. April May June July Aug.
S & P 425 Industrial Average
D-J Indust. Average
Daily Advance-Decline Ratio
Black = bearish selling pressure
10-day average-advances
10-day average-declines
Daily new lows (5-day average)
Daily new highs (5-day av.)
Odd-lot trading
net buying
net selling (black)
Odd-lot shorts (ratio)
Short interest ratio
Barron's Confidence Index
Barron's Business Index
Barron's Low Priced Stock Index
% of 89 stock groups holding above their moving averages
% of 432 stocks holding above their 200-day moving averages
Credit balances (cash in customers' accounts) $Bil.
Debit balances (margins) $Bil.
Eurosyndicat Share Index
London F. T. Average
Merkle Index of stock market activity (3,219 components)
London Fin. Times Index of S. African Golds (Kaffirs)
Yield- U.S. Treasury 91-day bills
average yield — 30 D-J Industrial stocks

The Composite Chart shows the leading industrial averages recovering the May-June losses to a greater extent than the A-D ratio. Daily new highs, a gauge of market strength on rallies, struck 25 (5-day average) on August 3, but this was far below the 1965 peak of 149 (recorded April 15). The short interest ratio at 1.47 is considered a plus factor, calculated to lend impetus to the advance. Perhaps the biggest news this week was the drop in Barron's Confidence Index from its multi-tested bottom at 95.9 to a new low of 95.7 (lowest level in 16 months). This new low provides little comfort to those who are hoping that a "new bull market" (rather than a bear market rally) is in the making. The percentage of 432 stocks holding above the moving averages rose to 25% this week, but this is still bearish in that it is far below the critical 50% level. Responding to Labor's latest deflationary edicts, the London market sank last week to a new 1965 low. At the same time the S. African gold index rose to 72.4, close to its four year high. The gold index contains many low-grade ore producers which in general have not acted as well as the golds suggested in these Letters. But over the past week new all-time highs were registered by such oft-recommended stocks as Western Deep Levels "B", President Brand, Western Areas, Welkom. I continue to recommend these four and other previously listed Kaffirs (i.e., Blyvoors, President Steyn, Free State Geduld, Western Holdings). Conclusion: The rally could go further, but the danger signals are there for us to see. Our policy is to hold 10 to 15% of our funds in assorted gold shares with the rest in 91-day Treasury bills. This writer assumed a token commitment last week in Cochenour Willans, a small but interesting Canadian mine, and added to his position in Western Areas (paying the new high asking price for the latter).

WATCH GOLD

Question: How does South Africa sell her gold?

Answer: Through the Bank of England, which acts as agent for the output of all S. African gold production.

Question: Who sets the price of gold?

Answer: Five gold houses (dealers) in London meet each day to set the gold price. These dealers are in close touch with both the Bank of England and the Gold Pool.

Question: What is the Gold Pool?

Answer: The Pool is a group of central banks made up of the Federal Reserve Bank of New York and the central banks of France, Belgium, West Germany, Italy, Britain and Holland. The Pool was set up in 1960 (at which time the price of gold ran up to $40 per ounce). The purpose of the Pool is to stabilize the price of gold by buying when conditions in the gold market are weak and selling when the price of gold threatens to run up.

Question: What happens when the price of gold does rise?

Answer: It costs about 8 3/4¢ to ship an ounce of gold from the U. S. to Europe. When the price of gold is above $35.08 (as it is now) then presumably the Gold Pool is losing gold. The Pool is half owned by the U. S.; for this reason, whenever the Pool is providing gold in an effort to hold down the price, half that gold must come from U. S. stocks.

* * * * *

With a war on its hands and with military expenses mounting, the U. S. continues on its flagrantly inflationary path of spending for Medicare, rent, housing, highways, unemployment and a thousand other items. Instead of tightening its belt as war clouds swirl, the Administration has put in effect the most gradiose spending program in this nation's history. All of which is having the effect of further weakening the dollar in the eyes of the world and centering attention on the time-honored measurement of true value — gold.

Like a debtor on the edge of bankruptcy, the U. S. has taken to issuing wild and far-fetched arguments in defense of its position. A few months ago a leading economist announced that the U. S. should simply refuse to purchase any more gold at $35 per ounce. "Since the U. S.'s promise to buy gold at $35 an ounce is the only factor responsible for holding up the gold price," reasoned this economist, then if the U. S. refuses to pay that price, gold holders will panic and the price will collapse. But the fact is that the U. S. has not bought gold on balance since 1957, and it therefore can hardly be claimed that U. S. buying has held up the price. Furthermore, since all newly mined gold (and more) is now going into private hoarding, even if the U. S. did express official disinterest in gold there would be little chance that the yellow metal would "go out of style."

Some months ago angry Senators advanced the idea that France should be made to pay off its huge War World I debt before she could exchange more of her dollar holdings of gold. But even Washington's Federal Reserve officials did not take this one seriously, and it was pointed out that prior agreements had literally cancelled these old debts. Furthermore, it was pointed out (not without embarrassment) that British World War I debts were larger than the French debts.

The latest "idea" was unleashed as the Senate Banking Committee (July 21) tentatively approved legislation empowering a Federal Reserve Bank to buy and sell securities of French and other foreign governments. Senator Douglas triumphantly announced that when France and other countries demand U. S. gold, we will be able to "trump their trick" by demanding their gold for U. S. held securities. But no one has explained how the U. S. will obtain these (French) securities. Since purchase of French stocks will eventually put the dollars (which were used to purchase the securities) back into French hands, the French will merely keep the round robin going by demanding gold for the dollars which arrived via purchase of French stocks. And another pathetic "plan of defense" will go by the boards.

But what I want to bring out in this discussion is the remarkable evolution which has taken place over the past few years, an evolution which runs something like this: (1) Gold, we have it coming out of our ears. Why Fort Knox is . . . (2) All right, we're losing gold, but we have so much gold it doesn't matter. (3) We're losing gold, but gold doesn't matter. (4) We've got to stop losing all this darn gold. (5) Who are the thieves who are taking all our gold? (6) By God, if they don't stop taking our gold, we'll figure a way of getting out gold back. And by the way, we're not going to devalue; the dollar is basically sound. (7) They — er, ah, are still taking out gold? But the dollar is basically sound. (8) Well, we are definitely not going to devalue, because that won't solve a thing — and the dollar is sound. (9) Secretary Fowler of the Treasury announces his wish to form an international conference for the purpose of discussing "monetary reform." What do you mean, the translation is that "the dollar is in trouble"? (10) You say that France has told us what we can do with our conference? You say that France and the rest of Europe are not interested in our monetary "reforms," that they are not interested in accumulating any more paper dollars. I can't understand .... gee, look at the gold price booming!"

APPRAISAL: The following are a series of long term considerations which should be studied by all true investors. I have commented upon these individually from time to time.

(1) Dow Theory — The Dow Theory gave a bear signal on June 25, 1965, when Industrials penetrated the 857.45 level, thereby confirming the prior bearish indication of the Rail Average. This was a warning which was heeded by all Dow Theorists; it was a clear signal which stated: "If you are not out of this market now, then you are "playing with fire." The odds have turned against you, and you are now invested against the trend."

(2) Dow's 50% Principle — This fundamental principle ceased being a bullish factor on the market in 1962. At that time the Industrial Average (see Letter 294) cracked the halfway level of the preceding major advance. This had not occurred in 20 years.

(3) Industrial Yields — While not a precise timing gauge (and this is true of almost all long-term measurements), Charles Dow always accorded great importance to yield or the return on investment. Dow believed that stocks were overvalued when (on average) they provided yields of 3½% or less. Except for a brief period at the 1962 bottom, average yields on the 30 Dow Industrial stocks have been in the danger area of 3½% or less yield since late 1958. The yield factor must therefore be considered negative.

(4) Crowd psychology is a very difficult phenomenon to measure. If we look at consumer spending, debt, attitudes and the "wild party" atmosphere of our times, we would have to conclude that the crowd is bullish and that the current atmosphere is typical of a New Era top.

But if we examine the current high short interest, the recent extended period of odd-lot selling and the recent of odd-lot selling and the recent odd-lot shorting we might conclude that much public uncertainty exists — at least in regard to the stock market. I list public psychology as a long-term bearish but short-term bullish factor.

(5) "Big Money" Psychology — The last Letter analyzed big block (over 10,000 shares) transactions as tabulated weekly in Barron's. Such transactions are an obvious clue as to what big money is doing. The latest figures for the week ending July 26 (during which time the market was rallying) show a continuation of the distributive process. Of 35 big blocks, 3 were executed on up-ticks and 22 on down-ticks. The ratio for the week was minus 54. Thus, big block ratios since June 28 (covering all the weeks since the June market lows) were June 29 minus 19, July 6 minus 39, July 12 minus 42, July 19 minus 59, July 26 minus 54. I therefore conclude (and this is confirmed by the Confidence Index) that big money has turned bearish on the market and is using this rally to distribute stocks.

(6) Monetary Picture: In the latest Bank Credit Analyst Mr. Hamilton Bolton notes that the negative monetary factors continue in effect. "The factors that turned our various indicators into negative territory last month for the first time in 57 months (thereby practically equalling the 60 month expansion from April 1924 to April 1929, which still stand as the all-time record length) have not changed appreciably," states Mr. Bolton. In a later section of his report entitled This Turning Point, Bolton states: "There are reasons to believe that this coming turning point is more important than any others at least in the postwar period." Among the important factors Bolton discusses are (1) the near-end of the current business cycle, (2) the unsustainability of many of the abnormal factors in the current cycle, (3) the international balance-of-payments dilemma, (4) the current very high level of investor confidence.

Conclusion: The Dow Theory has given its bear signal, and the stock market barometer is saying "storms ahead." Long term factors which I follow tend to re-emphasize the seriousness of the situation. I want to warn all my readers again that I see no point in holding stocks at this time (regardless of short or even intermediate term fluctuations). At times the prudent investor finds it best to stand aside in a fully protected position; I consider this to be such a time.

WATCH GOLDBERG: I have been thinking about and puzzling over the Vietnam situation for weeks now. Whatever political sense I possess tells me that there is far, far more to the Vietnam situation than meets the eye or the ear. I have been attempting to fit the pieces of the puzzle together, and this is the way I see it. First, we have to realize that Secretary McNamara has literally taken over the Vietnam situation; this "human I. B. M. machine" has become at once a Secretary of War, a Secretary of State, a Commander in Chief and a major policy maker. There is only one problem — McNamara's early theories and calculations about an easy Vietnam victory have proved wrong. Vietnam has become bigger and dirtier than McNamara ever dreamed it would.

Democrats in Congress are petrified. The great majority of Congress is silently against the whole ominous Vietnam situation. Johnson is appalled at what is happening; he is appalled at the direction in which the Vietnam conflict is pointing. Johnson (who dreams of being "the greatest President in U. S. history") sees the possibility of all his cherished welfare programs being forgotten in the face of a gathering Vietnam-Asiatic fiasco. How in the devil did he ever get into this mess, and how in the blue Texas blazes can he get out of it?

In his speech last week Johnson said almost nothing — increase the draft and keep a stiff upper lip — and we are willing to negotiate anytime, anywhere, anyplace, anyhow. Meanwhile, the Administration has been unable even to decide on what it is aiming at in Vietnam. Do we want a total victory, a holding operation, bases on the coast, what are we trying to do? If anybody in the Administration knows, they have not announced it.

My own opinion — get ready for some surprises regarding Vietnam. McNamara and the Administration have been wrong about the war, Johnson has been wrong in letting McNamara handle the war, Congress recognizes that the war is now a brewing mess, leading intellectuals and liberals oppose the war, Johnson wishes he had never heard of it. In the end, Saigon will have to negotiate with the Vietcong, and this fact is beginning to dawn on influential leaders in this country. Could Goldberg be the one to bring Saigon and the Vietcong together? Mr. Goldberg is recognized as one of the greatest "negotiators" in this nation; it is unlikely that he left his Supreme Court position for anything less than a try at greatness. My instincts say — watch Mr. Goldberg

SUNDRY COMMENTS: A great many people have written to ask the best method of holding Treasury bills. Here is an excellent method: open a special account under your name at the main branch of your bank. Bills are purchased at the main branch, placed in your account, and you are sent "Safekeeping Receipts" to show that the bills are held for safekeeping in your account at the bank. A week or so before the bills mature, the bank will call you for instructions, and you can then tell them to "roll the bills over" (i.e., buy the next maturity of 91-day bills). This will be done, and the new Safekeeping Receipts will be sent to you (thanks to Dr. Donald Marcus of Beverly Hills for this one).

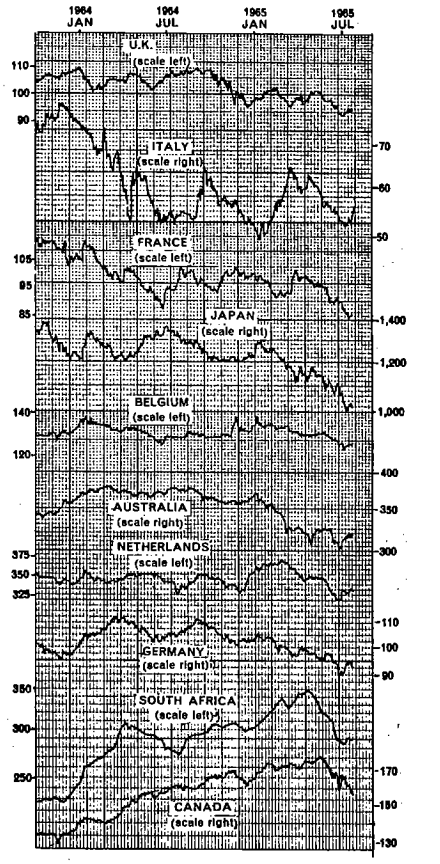
Dr. Sloan Wilson has started a new service (or actually he has "gone public" with his excellent "old" service). The reports are called Mission Market Musings, 5618 W. 62nd Street, Mission, Kansas, and I find Sloan's work packed with information, original studies and insights. If you want to see a copy of this "credit analyst" monthly, I believe he will send you a copy.

Follow-up on last week's discussion of France. This little clip (from Barron's roundup of world monetary conditions) speaks for itself. The French franc has now become the hardest currency in the world.

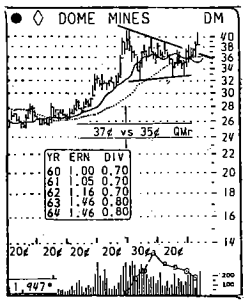
The French franc remained the strongest unit in Europe. French reserves continued to grow, at the end of June totaling $5,358.1 million, a rise of $254.1 million since January. The trade balance seemed to be improving, while the franc traded close to or at its upper limit of 20.408 cents.

A cynical adage states that when something makes the cover of Time Magazine, it's on its way out. The recent Time cover story on rock 'n roll music could have done it again (and I happen to enjoy the music). I note a definite swing over to the folk music and songs of social protest (and I mean they are on the top of the list). This could be part of the changing attitudes and mores which I feel will be a definite part of the world picture within the next year or so. Other signs of the times, the sharp slump in popular records in England, the disappearance of La Dolce Vita in Italy. One of the keenest observers of the world scene is my traveling friend Harry D. Schultz, now residing and writing his market report from Rome. Harry has his eyes on more things than any man I know, from world stock exchanges to point & figure charts to the latest style in French Bikinis. If you are interested in world markets, habits, comments, write for a copy of his fascinating report (Schultz, Villa Rosamar, 96 Ave. Jean Jaures, Rocquebrune, Cap Martin, A.M. France). Schultz's book, "Bear Markets," by the way, is my best seller and has been for the past six months.

My friend Irving Weiss (Capital Advisors, Inc., 50 Broad St., N. Y.) has been following the Japanese situation closely, feels it may foreshadow events here. Writing about the Japanese slump, the inventory pile-up, and the slowdown in turnover, Weiss notes that as of June 1, 1.6 million cameras (four month's production) were piled up in Japanese warehouses, 200 million square feet of glass, pile-ups in plastics, textiles, tires, batteries, refrigerators, etc. This is going to mean a vicious export attack at cut-rate prices. "Japan's steel mills are in serious difficulty," writes Weiss. "Their domestic market is beginning to fall apart, and they are now out to sell every ton of their huge output of steel to the overseas market — and the U. S. is their prime target."

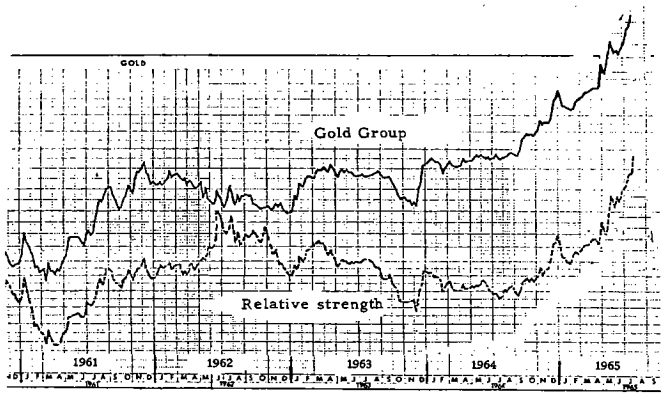


Because the world situation is now so critical, I again include a chart of the 10 leading foreign exchanges in the Free World. With the downturn in S. Africa's industrial average and that of Canada, the picture is complete — bear markets throughout the world. Perhaps some of the repercussions of this situation are now becoming apparent; for instance, from today's D-J news ticker, U. S. imports for June are up 2%, U. S. June exports are down 4%. A decline in exports is the last thing this country needs now, but with our "customers" all in the throes of economic contraction, this is exactly what is going to happen. (Foreign chart courtesy of International Investor, 50 Denmark Hill, London, S. E. 5, England).



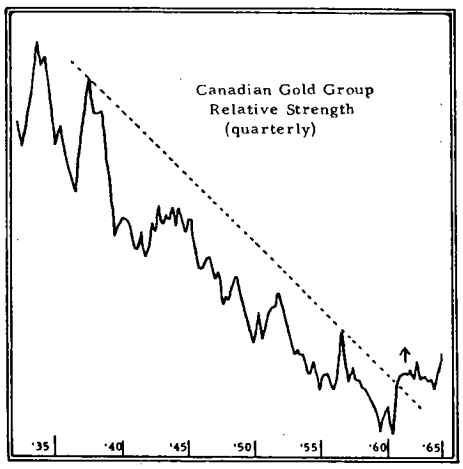
STOCKS: I apologize to older readers of these Letters who may now own gold stocks, but I am taking a lot of space to talk about gold shares for the following reasons: (1) New subscriptions here are running at the highest rate since I began this service. These new readers are not aware of the gold situation. (2) Primary bull trends are hard to find these days. The gold trend is a primary bull trend, and a strong one. (3) I know from experience that it takes a good deal of prodding to get my subscribers to move. I want all subscribers to have at least a token position in golds.

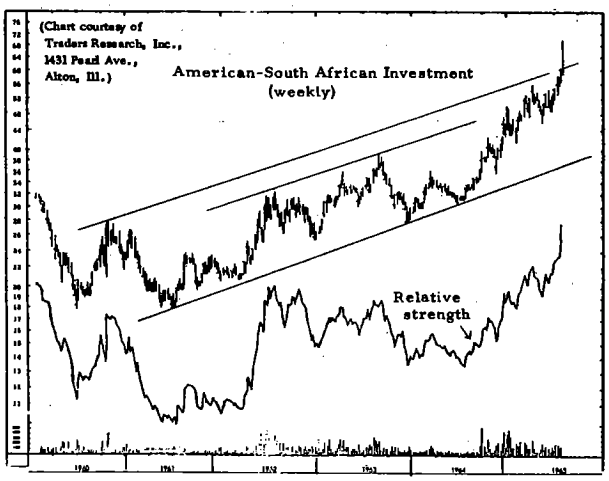
Back in Letter 276 I showed a 40-year relative strength (RS) chart of the Canadian gold group. I have included that chart again (chart courtesy of Ray * Signals, 141 B'way, N.Y.C.) to provide perspective for this move. When an RS downtrend continues for 30 years, it means that everybody who ever owned shares or traded in that trend is disgusted. For 30 years the gold shares have acted poorer than the market. Result — the public and the speculators are out of the group, and the investors are in. Now the RS in golds has turned up. Is there any wonder the broad upmove in gold is getting violent. Like a giant awakening, the gold group is pushing out — despite lack of sponsorship from brokerage houses, despite official denials, despite appeals to patriotism, despite threats from Washington. That is how primary movements work.



The weekly chart shows the gold group and its RS line touching new highs last week and again this week. The move is assuming an upward momentum which is beginning to electrify Wall Street.

Finally, the weekly chart of American-South African (see Letter 294) shows this stock surging above its upper channel line. This stock is beginning to "blow," and I believe the institutional buying is now coming into this issue. The chart of Dome shows that issue pushing out of a large triangle and joining in the gold rally. It should be an interesting fall season for holders of gold shares.





Late Note: (Noon, Thurs., Aug. 5) Yesterday Industrials confirmed by closing above 883.23, and the rally continued rather gingerly this morning. The market seems bewildered by announcement of another 2¢ rise in London gold (to highest in 4 years) and an accompanying surge of high volume buying in all golds, taking Dome to an all-time high and ASA to record highs in the 70's! The breakout (42) on DM measures to above 50 on point & figure.